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From sole trader to a limited company

What to expect from incorporating your business.

With a new tax year almost upon us, many sole traders will be reviewing their business structure and considering whether it's worth switching to a limited company.

There's no denying that incorporating a business proved popular in 2017, with Companies House reporting a 7% rise in the number of actively trading companies – bringing the UK total to 1.9 million.

Last year's statistics also showed this trend is no flash in the pan as the number of actively trading companies increased by around 610,000 since 2010.

If you're a sole trader who has weighed up the pros and cons and decided to form a limited company, here's what you need to know to complete the transition.

Where to start

As a sole trader, there's little distinction between you and your business so it's important to know that moving to a limited company will mean your business becomes its own legal entity.

Before you stop working as a sole trader, you should settle on a unique name for your company (one that is not being used by another company) and on the following details:

- a standard industrial classification of economic activities (SIC) code
- a memorandum of articles and association
- a people with significant control (PSC) register, such as someone who holds a 25% stake in your company or has voting rights.

You will need these details when the time comes to register your organisation with Companies House, and to register for corporation tax with HMRC.



Company bank account

If you don't already have a bank account set up in the name of your business, setting one up in the name of your limited company is usually one of the next steps to take.

This will make it easier for you to handle the more complex and often time-consuming accounting processes involved after you've started trading as a limited company.

It would also be wise at this stage to look into hiring an experienced accountant, who can work with you to potentially reduce your tax liabilities further down the line.

Contact HMRC

You should let the Revenue know at the earliest opportunity that you've stopped, or when you intend to stop, working as a sole trader.

Depending on when you cease working as a sole trader, HMRC will expect you to file a tax return under self-assessment for the rest of the year and possibly the previous year.

You may then have to submit tax returns the following year as a director and shareholder.

However, this guidance is misleading as a tribunal case in 2017 stated a director is only obliged to file a return if they receive a notice – and "that is not what the government guidance says".

It's worth bearing in mind that the cost of challenging the Revenue's opinion on whether or not a director should submit a tax return will usually exceed the cost of completing a tax return.

Register with Companies House

The next step is to register – either online or through the post – with Companies House, which deals with incorporating new companies and dissolving existing ones.



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You will need your company name, a company address, and at least one director and shareholder.

You'll also require the aforementioned details, including your SIC code, your memorandum of articles and association, and your PSC register.

Once you have these details, you pay £12 to register online with Companies House and the process can take up to 24 hours to complete.

Postal registrations can take up to 10 days and cost £40, although a same-day service is available for £100 so long as the application is received before 3pm.

In both cases, send a cheque made payable to Companies House along with a completed form IN01 to register, and send your application to the address on the form.

Your company can then begin actively trading once it receives a certificate of incorporation.

Corporation tax

You must also register with HMRC to pay corporation tax within three months of doing business.

Business in this context includes any buying, selling, advertising, renting a property and employing someone. Be aware you may face a fine if you fail to register within the first three months.

Wherever your limited company is based in the UK, you will pay corporation tax at 19% on any profits you make in 2018/19.

That may sound like a large chunk of your income going to the taxman, but the UK rate of corporation tax is actually one of the lowest in the developed world – and is set to fall to 17% by 2020.

Registration

You will need your company's 10-digit unique taxpayer reference before you register for corporation tax, which will be posted to the company address you submitted to Companies House.

When you're in a position to register with HMRC for corporation tax, you will need:

- your company's registration number
- the date you started trading (to determine the start of your accounting period)
- the date your annual accounts are made out to.

You will then receive a deadline for paying corporation tax, and it's also wise to be aware you'll need to file a tax return regardless of making a profit or loss.

Reliefs

Small businesses can take advantage of the **research and development (R&D)** scheme, which offers relief on 230% of qualifying R&D costs.

It allows your business to deduct 130% of your qualifying costs from your annual profits on top of the standard 100% deduction.

In certain circumstances, loss-making companies can surrender their losses in return for a payable tax credit worth up to 14.5% of the loss rather than paying corporation tax at 19%.

The **patent box** enables incorporated companies to reduce their corporation tax rate from 19% to 10% on any qualifying patents or similar intellectual property.

It's also possible to claim back **capital allowances** on items, such as any machinery, equipment or vehicles, which are used by your company or any of your staff.

There are various allowances and reliefs to potentially help reduce your corporation tax bill, and we can help you find which ones may be applicable to your company.

Reporting and payments

As a director of a limited company, it is essential for you to maintain accurate records for paying corporation tax.

For this reason, and the looming prospect of Making Tax Digital, it's worth considering the use of cloud accounting software.

Not only will it help you remain compliant, it will make our job considerably easier to minimise your tax bill.

Make sure you keep all receipts, expenses, sales and purchases, plus up-to-date records of any company assets, liabilities and stock if your company is selling goods.

These records must be retained for six years after the tax year they related to.

For taxable profits up to £1.5 million, you will pay your corporation tax bill nine months and one day after the end of your accounting period. Anything above this threshold and you pay corporation tax by instalments.

You must pay corporation tax before your deadline to avoid any fines and any interest accruing, and the fastest ways to pay are by either paying online, over the phone or through CHAPS.

We can process your corporation tax bill.